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C O N F I D E N T I A L SECTION 01 OF 03 SHANGHAI 000526

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TAGS: PREL PGOV ETRD ECON ELAB EFIN CH TW

SUBJECT: GLOBAL ECONOMIC CRISIS HURTING TAIWAN BUSINESSES IN KUNSHAN,  
SEE LITTLE BENEFIT FROM SEF-ARATS AGREEMENTS

REF: A. A) TAIPEI 1564  
¶B. B) SHANGHAI 306  
¶C. C) SHANGHAI 503

CLASSIFIED BY: Simon Schuchat, Deputy Principal Officer, U.S.  
Consulate, Shanghai, U.S. Department of State.

REASON: 1.4 (b), (d)

¶1. (C) Summary: Taiwan entrepreneurs in Kunshan, Jiangsu Province, said the global economic downturn has severely impacted their businesses, with orders for electronic components, the mainstay of Kunshan's Taiwan manufacturers, down at least 20 percent this year. Several large Taiwan factories in Kunshan have closed recently, they said. Rising labor and material costs, RMB appreciation, and changes in VAT rebate policy have also hurt their bottom line, according to the businesspeople. However, none of the interlocutors expressed a desire to return to Taiwan, stating that Taiwan's economy is even more "depressing." They think the agreements on direct links signed during the recent SEF-ARATS talks in Taiwan (Ref A) will have limited impact on their businesses. They believe the next round of talks will focus on financial matters, which may help spur investment on both sides of the Strait. The interlocutors were not enthusiastic about Taiwan President Ma Ying-jeou's performance during his first six months in office.  
End Summary.

¶2. (SBU) On December 3, Econoff met with eight entrepreneurs of the Kunshan branch of the Taiwan Compatriot Investment Enterprises Association (Taixiehui), a trade association with branches in many major cities across China representing the interests of Taiwan companies operating in the Mainland. According to Zhou Zhihua, Vice Chairman of the Kunshan Taixiehui, there are about 3000 Taiwan enterprises and 50,000 Taiwan people living in Kunshan. Kunshan is located in Jiangsu Province, approximately an hour's drive west of Shanghai. A town of rice paddies only 20 years ago, Kunshan has quickly developed into a commercial center for manufacturing and export.

Many of the Taiwan firms in Kunshan are OEMs (Original Equipment Manufacturers) producing electronic and computer components for multinational companies (MNCs). Interlocutors included representatives from an auto parts company, computer components company, household products company, real estate development company, and food store chain.

## Economic Downturn Hitting Taiwan Businesses

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¶3. (C) Taiwan entrepreneurs from the Kunshan Taixiehui said the global economic downturn has severely impacted their businesses.

He Xinfu, Vice Chairman of the Kunshan Taixiehui, estimates that both domestic and overseas orders for computer and electronic components are down 20 percent this year. Another interlocutor in a separate conversation said the figure is probably closer to 50 percent. He Xinfu thinks that the industry will start focusing more on the domestic market, as overseas orders have been hit especially hard. According to Huang Jianzhong, CEO of a food store chain, several large Taiwan OEMs in Kunshan, each with over two thousand employees making electronic and computer components, have closed in recent months.

¶4. (C) Timothy Lin, CEO of a household products company with over 600 employees, was especially downbeat, saying he has had "zero orders" from the United States, his main overseas market, the past few months. He characterized the general manufacturing and export business in the Mainland as "very bad," saying he is being forced to shift his business model from manufacturing low-end products for export to importing higher-end foreign products for sale in the Chinese domestic market. "More and more Chinese consumers want higher-end household products with international labels," he said. Lin believes the old model of exporting cheap products is outdated, given the global economic situation and rising costs in the Mainland.

¶5. (C) Hank Yang, CEO of Allways Friction Material, a company of over 200 employees manufacturing auto parts, said his business is 50/50 exports and domestic sales. Yang said both exports and domestic sales are down significantly from last

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year. "People are no longer buying cars," he said. However, he sees a silver lining, explaining that if he focuses his business on after-sales service and sales of parts for maintenance, he may be able to compensate for the decline in other sales. "People are keeping their old cars longer, which means more maintenance expenditures," he said.

## Other Factors Hurting Business

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¶6. (C) In addition to the global economic downturn, the Taiwan entrepreneurs cited RMB appreciation and higher labor and material costs as other factors hurting their bottom line. The Labor Contract Law has raised costs and made the labor market more rigid, said several interlocutors. Although commodity costs have come down in recent months, they have still increased significantly since last year, according to Timothy Lin, who estimates that the cost of steel components he uses to make household products increased 50 percent from last year. Several interlocutors also called the VAT rebate policy "confusing," noting that rebates went down from 17 percent to 9 percent and then were recently raised again. Hank Yang said the rebates have a "huge impact" on his business, and although the recent increase was welcome, the frequent changes make it hard for him to project total costs and profit. (Note: A discussion in August with Taiwan businesspeople in Hangzhou revealed similar concerns about RMB appreciation, rising labor and material costs, and VAT rebates. See Ref B. End Note.)

## Staying Put in Kunshan

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¶7. (C) Despite declining business confidence in the Mainland, none of the interlocutors expressed a desire to return to Taiwan. They still see more business opportunities in the Mainland than in Taiwan, calling the Taiwan economic situation "depressing." Although several said they would consider investing in Taiwan in the future "to help their homeland," most of the interlocutors said they consider Kunshan their "home" now. They lauded Kunshan for its business-friendly environment, especially the "strong support" given by the local government to Taiwan firms. Although business is down in Kunshan, the situation is much worse in Dongguan (Guangdong Province) and

other manufacturing and export centers, said He Xinfu. Yeh Cheng-wu, General Manager of Coimo Electronics Company, an OEM that makes computer components, said Kunshan's advanced supply chain and logistics infrastructure give it a competitive edge over other Mainland cities. Ke Yiru, a marketing executive of a construction company, said she feels safer in Kunshan than in Taiwan, and that life in Kunshan is "very comfortable."

#### Limited Economic Benefit from Agreements

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¶8. (C) The Taiwan entrepreneurs do not expect the recent SEF-ARATS agreements on direct links (Ref A) to have a substantive impact on their businesses. Direct flights will be "convenient" they said, with airfare and flight time between Shanghai and Taipei reduced significantly. However, the benefits will be limited to personal convenience since company employees do not travel between Taiwan and the Mainland very often, they said. The interlocutors also said the direct flights will not prompt them to shift their back-office and service functions back to Taiwan since personnel costs are still much cheaper in the Mainland. (Note: One academic in a previous discussion had speculated that direct flights would result in Taiwan firms moving back-office and service functions from the Mainland to Taiwan. See Ref C. End note.)

¶9. (C) Yeh Cheng-wu of Coimo Electronics Company estimates that the direct shipping agreement may reduce shipping costs by 30 to 40 percent, and that these savings for his company may be realized by the next quarter. But the reduced costs would only apply to processed components shipped from Taiwan to the Mainland. Since most of the products are manufactured in Kunshan and exported directly from Shanghai to overseas markets without passing through Taiwan, the direct shipping agreement will only have limited impact on their businesses, said most of the interlocutors.

#### Expectations for Future Talks

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¶10. (C) He Xinfu thinks the next round of SEF-ARATS talks will focus on financial and business matters. He believes future agreements will lead to a doubling of Taiwan investment in the Mainland in the "near future" as well as more Mainland investment in Taiwan's tourism, real estate, and financial sectors. A few interlocutors were less optimistic, saying that the only major benefit they see in the near term is a possible relaxation of restrictions on Taiwan banks operating in the Mainland. Timothy Lin and Hang Yang both complained that they can only get one-year loans from Mainland banks. The banks force the companies to repay their loans every year, and the banks check the companies' financial status annually before deciding whether or not to renew the loans. Lin and Yang think there may be a gradual relaxation of restrictions in the future but that Mainland banks will "resist" opening the market to Taiwan banks.

#### Not Impressed by Ma

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¶11. (C) The interlocutors were not enthusiastic about Taiwan President Ma Ying-jeou's performance during his first six months in office. He Xinfu, the most positive of the interlocutors, said Ma "achieved 70 percent" of what was expected. He pointed to the agreements on direct links as one positive accomplishment. Others roundly denounced Ma for his "lack of vision" and for being a "typical politician" who wants to "control the public through the media." One interlocutor complained that Ma has not clarified "what kind of place Taiwan will be in the future...Will it be the financial center, the arts capital, or the R&D center of Asia?" he asked. When asked what percentage of Kunshan's Taiwan businesspeople are pro-KMT and pro-DPP, one interlocutor estimated they are divided 50/50, but that most DPP supporters "keep their mouths shut" in the Mainland. The businesspeople "do not really care about politics as long as the politics don't get in the way of business," he said.

Comment

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¶12. (C) The challenges facing Taiwan entrepreneurs in Kunshan are similar to those facing other exporters in East China: falling global demand, RMB appreciation, and rising labor and material costs. Like Taiwan businesspeople in Hangzhou (Ref B), the entrepreneurs in Kunshan expressed little interest in the cross-Strait political situation, saying the recent thaw in relations has not had a direct impact on their businesses though psychologically, they feel more at ease now knowing that a sudden flare-up is unlikely. According to our interlocutors, the Kunshan local government is very supportive of their businesses, but the Chinese Central Government still views Taiwan businesses in the Mainland with "some suspicion," demonstrating that local and Central Government interests do not always coincide.

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